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Debunking the Mercantilist Trade Doctrine

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Table 2
The Trade Balance and U.S. Economic Performance, 1980–2010

Periods by Quarters			Trade Balance as % GDP				Economic Indicators, Annualized Change					
Start	End	Total	Start	End	Total Change	Change/ Year	Real GDP	CPI	SP 500	Manu- facturing	Employ- ment	Job- less %
Contracting Trade Deficits												
1987:4	1992:1	17	-3.1%	-0.4%	2.8	0.7	2.1%	4.4%	11.9%	0.9%	0.9%	0.4
2000:4	2001:4	4	-4.0%	-3.4%	0.6	0.6	0.4%	1.9%	-18.2%	-5.5%	-0.8%	1.6
2006:3	2008:3	8	-5.9%	-5.2%	0.7	0.4	1.0%	3.8%	-1.4%	-1.2%	0.2%	0.7
2008:3	2009:2	3	-5.2%	-2.3%	2.9	3.9	-4.1%	-3.0%	-36.3%	-16.1%	-4.5%	4.4
Weighted Averages						0.9	1.0%	3.3%	0.3%	-2.0%	0.0%	1.0
No Trend												
1980:4	1982:2	6	-0.4%	-0.3%	0.1	0.1	0.1%	8.0%	-9.8%	-3.2%	0.2%	1.3
1984:4	1987:4	12	-2.8%	-3.1%	-0.3	-0.1	3.8%	3.1%	15.6%	3.9%	2.3%	-0.5
1995:2	1997:3	9	-1.6%	-1.2%	0.4	0.2	4.3%	2.5%	29.1%	6.8%	1.9%	-0.4
Weighted Averages						0.0	3.1%	4.0%	14.5%	3.3%	1.7%	0.0
Expanding Trade Deficits												
1982:2	1984:4	10	-0.3%	-2.8%	-2.5	-1.0	5.2%	3.8%	15.9%	6.0%	2.4%	-0.8
1992:1	1995:2	13	-0.4%	-1.6%	-1.2	-0.4	3.2%	2.9%	7.7%	5.2%	1.7%	-0.5
1997:3	2000:4	13	-1.2%	-4.0%	-2.8	-0.9	4.1%	2.5%	12.5%	4.6%	1.7%	-0.3
2001:4	2006:3	19	-3.4%	-5.9%	-2.5	-0.5	2.8%	2.9%	3.0%	3.0%	1.3%	-0.2
2009:2	2010:4	6	-2.3%	-3.2%	-0.9	-0.6	3.0%	1.4%	22.1%	7.3%	-0.6%	0.2
Weighted Averages						-0.6	3.6%	2.8%	11.3%	5.2%	1.4%	-0.4
Averages, 1980–2010							2.8%	3.2%	7.6%	2.5%	1.1%	0.1

Sources: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; Wells Fargo Advisors; Federal Reserve System.

The general public, politicians, the media, and even some economists have bought into a false mercantilist doctrine that: a) exports are good for the economy and b) imports are bad for the economy, which therefore implies that: c) trade deficits are bad for the economy and d) trade surpluses are good for the economy. In a recent paper from the Cato Institute titled "The Trade-Balance Creed: Debunking the Belief that Imports and Trade Deficits Are a 'Drag on Growth,'" Daniel Griswold debunks that "consensus creed," here's a key excerpt:

> What the past 30 years show is that the U.S. economy exhibits no sign of suffering during periods when the trade deficit is expanding. To the contrary, ***the U.S. economy grew more than three times faster during periods when the trade deficit was expanding as a share of GDP compared to those in which it was shrinking*** (see chart above, click to enlarge):
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> 1. Stocks, as represented by the ***Standard and Poor's 500 Index, climbed an annualized average of 11 percent during periods when the trade deficit was "worsening," compared to a less than 1 percent*** annual advance during periods when the deficit is "improving."
>
> 2. Despite worries about the impact of the trade deficit on the U.S. industrial base, ***manufacturing output expanded a robust 5.2 percent a year during periods of rising deficits, in contrast to a 2.0 percent decline when the deficit was contracting.***
>
> 3. Trade deficits are routinely blamed for job losses, yet ***civilian employment grew a healthy 1.4 percent annually during periods of rising trade deficits while job growth was virtually zero during those periods when the deficit was declining.*** Ditto for the unemployment rate. The jobless rate ticked down 0.4 percentage points per year on average when the trade deficit was on an upward trend, and jumped a painful 1.0 point per year when the trade deficit was shrinking. In four of the five periods in which imports did outpace exports, the unemployment rate fell, and in every period in which imports grew more slowly than exports, or fell

more rapidly, the unemployment rate rose.

4. Although the creed would imply that declining deficits should accompany economic expansions, they are invariably linked with recessions. In fact, all three of the periods of declining trade deficits include the three most recent recessions. ***The Great Recession of 2008–09 coincided with the sharpest "improvement" in the trade deficit in the past 30 years.*** That is small comfort to the eight million Americans who lost their jobs during the recent downturn.

Here's Dan's conclusion: "The time to reform the prevailing doctrine of the trade balance is long overdue. The goal of U.S. trade policy should not be to maximize exports and minimize imports in a misbegotten quest for "balanced trade." The goal should be to maximize the freedom of Americans to buy and sell in global markets for mutual gain, whatever the mix of goods, services, and assets we freely choose to trade."